

Briefing Office and retail investment

May 2016



Image: Hong Kong nightview

SUMMARY

Suburban retail assets continue to attract investment interest.

- Nine shopping malls were sold by the Link REIT in April 2016 at prices 18% to 81% higher than their respective valuations, reflecting strong interest in suburban retail despite declining retail sales.

- The five batches of Link REIT properties, together with other suburban retail deals over the past two years show some clear delineation of the broader suburban retail market among different geographical locations.

- Office transaction volumes remained thin and any deals concluded are making headlines with record prices.

- We note a gradual reshuffle of trade mix on prime streets as some outgoing luxury retail brands are replaced by more local, mid-tier retailers, in particular F&B.

- Suburban retail premises should continue to attract interest in the coming months with a pipeline of projects for sale, but the same cannot be said for their prime location counterparts with rents and prices likely to soften further.

- The strata-title office market may remain quiet over the next few months but prices may not come under too much pressure as there will be significantly less new supply in decentralized areas earmarked for strata-titled sale.

.....
 "The latest successful sale of nine shopping malls by Link REIT indicates sustained interest in the suburban retail market. While few noticeable office transactions were concluded, declining strata-titled supply may support prices." Simon Smith, Savills Research

→ **Key themes**

The Link REIT announced the disposal of another nine shopping centres from its portfolio in April for a total consideration of HK\$3,690 million, with the selling prices of the nine centres at 18% to 81% premiums over their respective valuations at the end of March in 2015. The strong response reflected robust investment interest in suburban retail premises, even though the latest retail sales figure showed an across-the-board decline (-13.6% y-o-y over the first two months of 2016), including both tourist items (such as jewellery, watches and clocks which declined by 24.2% y-o-y) and local spending items (foodstuffs -2.0%, consumer durables -25.9% and department store sales -12.3%).

The buyer profile (below) also indicates a shift in buyer preference: while the largest two centres were bought by seasoned investors with prior involvement in the suburban retail sector, the remaining assets attracted interest from new investors to either suburban retail or to the Link REIT portfolio, or both. Investors well stocked with suburban premises may

MAP 1 **Geographical distribution of suburban shopping centre transactions, Jan 2014 – Apr 2016**



Source: EPRC, Savills Research & Consultancy

have adopted a more cautious stance given the current retail market status, while other newcomers were keen to jump on the bandwagon.

The suburban retail investment market has been dominated by

the divestment of five batches of the Link REIT portfolio over the past two years, with 23 out of 28 suburban shopping centres sold by the Link REIT. The geographical distribution of these transactions also showed some interesting

TABLE 1 **Latest Link REIT divestment of nine retail premises in 2016**

Property	District	IFA (sq ft)	Consideration (HK\$ million)	Appraised value at 31 Mar 2015 (HK\$ million)	Price premium	Estimated NPI yields	Purchaser
Shek Yam Shopping Centre	Kwai Chung	75,270 (424 car parks)	880.0	639.4	37.6%	3.4%	Yan Yan Motors
Wan Tau Tong Shopping Centre	Tai Po	54,464 (438 car parks)	810.3	689.0	17.6%	4.3%	Prosperous Glory Investment
Kam Ying Court Shopping Centre	Ma On Shan	37,260 (492 car parks)	471.0	383.0	23.0%	3.6%	Win Glories
Po Tin Shopping Centre	Tuen Mun	63,505 (62 car parks)	437.8	350.5	24.9%	3.8%	Capitol Investments
Tin Ma Court Commercial Centre	Wong Tai Sin	37,900 (585 car parks)	308.0	236.1	30.5%	3.0%	Excelskill
Hing Man Commercial Centre	Chai Wan	33,915 (226 car parks)	208.888	115.6	80.7%	2.1%	Ace Ample Hong Kong
Retail and Car Park within Mei Chung Court	Tai Wai	1,077 (385 car parks)	204.134	168.9	20.9%	3.9%	Hong Yang Investments
Retail and Car Park within Po Nga Court	Tai Po	13,951 (246 car parks)	150.889	107.8	40.0%	3.2%	Tung Fai Kee Wooden Materials
Retail and Car Park within Yan Shing Court	Fanling	11,810 (252 car parks)	180.889	114.7	57.7%	2.9%	Tung Fai Kee Wooden Materials

Source: Company announcements, Savills Research & Consultancy

→ delineation within the broad suburban retail market.

Nine transactions took place in the broader Kowloon East / Tseung Kwan O area with the CBD2 initiative an obvious driver, and the anticipated dramatic increase in the residential population due to the phased completion of the Kwun Tong Town Centre redevelopment as well as the upcoming completion of various housing estates, in particular the later phases of LOHAS Park in Tseung Kwan O. Four suburban retail premises were sold in the Kwai Chung / Tsuen Wan area with buyers eyeing its gradual transformation into a

decentralized office area as well as the increasing local population especially in the Tsuen Wan West area.

Three transactions were recorded in both the Tuen Mun and North areas with different perspectives: buyers of Tuen Mun centres are looking at its future connectivity to the airport and at the Hong Kong-Zhuhai-Macao Bridge via the Tuen Mun-Chek Lap Kok Link to be completed in 2018; whereas new suburban centre owners in the North are looking to the vast increase in population to be relocated to the area as a result of the North East New Territories New Development Areas initiative.

Retail market snapshot

We note a gradual reshuffle of the trade mix on prime streets as some outgoing luxury retail brands are replaced by more local, mid-tier retailers, in particular F&B. A 1,000-sq ft shop at 504 Lockhart Road, Causeway Bay has been leased to a local siu mei restaurant for a monthly rent of HK\$330,000 per month, after the outgoing tenant, a luxury handbag retailer, decided not to renew the lease about a year ago. Such trade mix rebalancing was also observed in other parts of Causeway Bay, as well as in some parts of Tsim Sha Tsui and Central.

TABLE 2 Major retail transactions (over HK\$60 million), Q1/2016

Date	Property	District	GFA (sq ft)	Consideration (HK\$ million)	Average price (HK\$ psf)	Purchaser
Mar-2016	Shop on G/F and M/F, 170 Castle Peak Road	Yuen Long	1,200	95	79,167	TBC
Mar-2016	Unit 56 on G/F and cockloft, Lucky Court	Tin Hau	TBC	90	TBC	Land East Ltd
Mar-2016	Shop on 1/F, Well On Shopping Arcade	Tseung Kwan O	20,500	88	4,293	TBC
Mar-2016	G/F, 51-53 Jardine's Bazaar	Causeway Bay	700	68	97,143	TBC
Mar-2016	G/F, Winful Centre	Kwun Tong	5,300	66	12,453	TBC
Mar-2016	Shop C on LG/F and UG/F, Po Fat Building	Western	TBC	63.223	TBC	Harvest Treasure Ltd
Feb 2016	G/F-2/F, Lee Kee Building	Ngau Tau Kok	30,600	240	7,843	TBC
Feb 2016	Shop A on G/F, 1A Humphreys Avenue	Tsim Sha Tsui	1,200	200	166,667	Teamwell Int'l Properties Ltd
Feb 2016	LG/F & G/F, 46-48 Cochrane Street	Central	TBC	90	TBC	Able Wealth Enterprise Ltd
Feb 2016	Shop C on G/F, 3 Tai Yau Street	San Po Kong	TBC	67.642	TBC	TBC
Feb 2016	Shop 2 on G/F, Park Hotel	Tsim Sha Tsui	600	67	111,667	Hero Richest Ltd
Feb 2016	Shop F on G/F, Yan On Mansion	Kwun Tong	1,100	63.8	58,000	Tai Hing
Feb 2016	G/F & M/F, 218 Johnston Road	Wan Chai	TBC	60.38	TBC	New Core Ltd
Jan 2016	Shop on 1/F, Wing Fok Centre	Fanling	15,000	99	6,600	TBC
Jan 2016	Shop B on G/F, 3 Tai Yau Street	San Po Kong	2,735	75.91	27,766	TBC
Jan 2016	Shop E G/F, General Commercial Building	Central	TBC	62	TBC	East Champ Int'l Ltd
Jan 2016	Shop on G/F, 156-164 Des Voeux Road Central	Central	740	60	81,081	TBC

Source: Land Registry, Savills Research & Consultancy

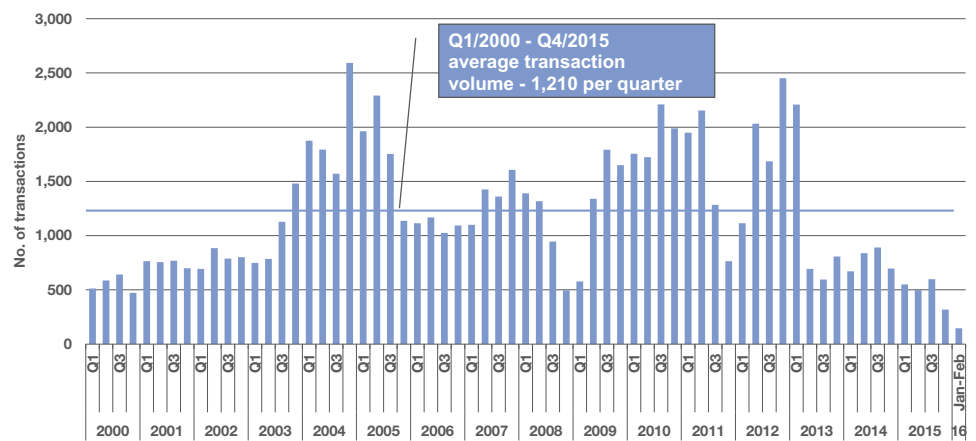
→ Retail transaction volumes were unimpressive in the first two months of 2016 with prime street shop landlords more receptive to rental rather than price declines, and the 147 transactions in January and February this year were again the lowest figures for any first two months since 1998 (the first year official monthly data was being published). Prime street shop prices declined by 3.6% in Q1/2016 as a result, with rental declines moderating slightly to 5.4% over the same period. Retail yields remained broadly stable at 2.8% in Q1/2016.

Office market snapshot

Office sales market sentiment continued to drift with only 64 transactions recorded over the first two months of 2016, a 44% y-o-y decrease and the worst start to any year since 1998. While the price gap between vendors and purchasers was the main reason behind the dormant market, the deals which were actually concluded over the quarter were the ones with high lump sums or high average prices or both, the most significant being the sale of 26/F and 27/F of Worldwide House in Central by Wheelock Properties for HK\$726 million (HK\$35,000 per sq ft) via a company transfer, a record high for the building.

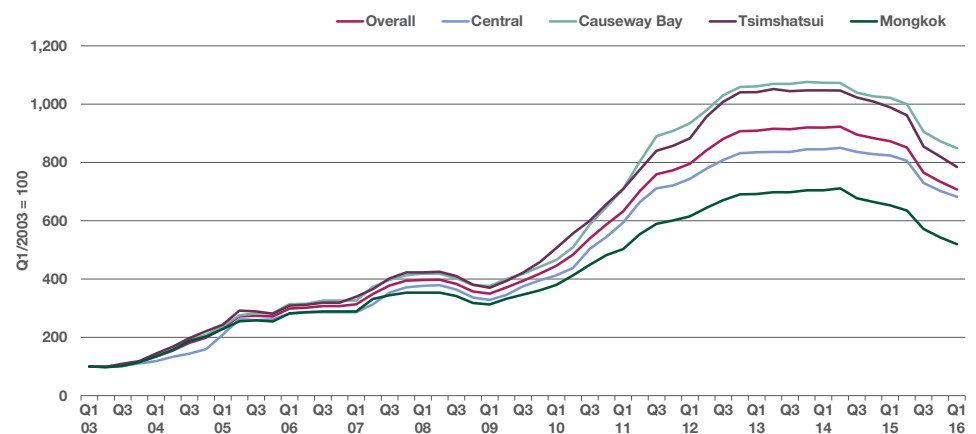
While the headline deals kept office price growth in positive territory in both Central and Wanchai /

GRAPH 1 Retail transaction volumes, Q1/2000–Jan-Feb 2016



Source: Rating and Valuation Department, Savills Research & Consultancy

GRAPH 2 Prime street shop price indices by district, Q1/2003 – Q1/2016



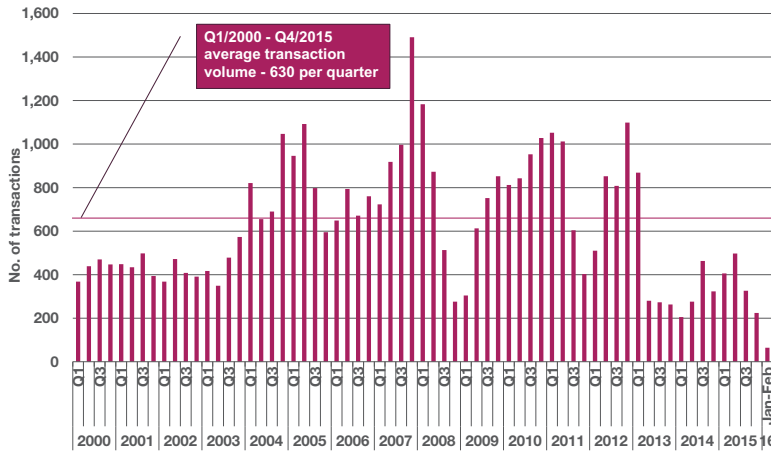
Source: Rating and Valuation Department, Savills Research & Consultancy

TABLE 3 Major strata-titled office transactions (over HK\$60 million), Q1/2016

Date	Property	District	GFA (sq ft)	Consideration (HK\$ million)	Average price (HK\$ psf)	Purchaser
Mar 2016	26 & 27/F, Worldwide House	Central	20,766	726	35,000	TBC
Mar 2016	24/F, Lippo Centre Tower 1	Admiralty	14,984	372	24,826	TBC
Mar 2016	Mid-floor units, Shun Tak Centre West Tower	Sheung Wan	6,830	114.7	16,794	TBC
Feb 2016	32/F, Billion Centre Tower A	Kowloon Bay	TBC	170	TBC	Shin Tech Engineering Ltd
Feb 2016	4/F, V Heun Building	Central	TBC	61.5	TBC	Billion Alliance Holdings Ltd
Jan 2016	Top floor unit B, 3 Tai Yau Street	San Po Kong	8,349	98.8	11,839	TBC
Jan 2016	6/F, King Kong Commercial Centre	Western	TBC	74.5	TBC	Bigshot Inv Ltd

Source: Land Registry, Savills Research & Consultancy

GRAPH 3 Office transaction volumes, Q1/2000 – Jan-Feb 2016

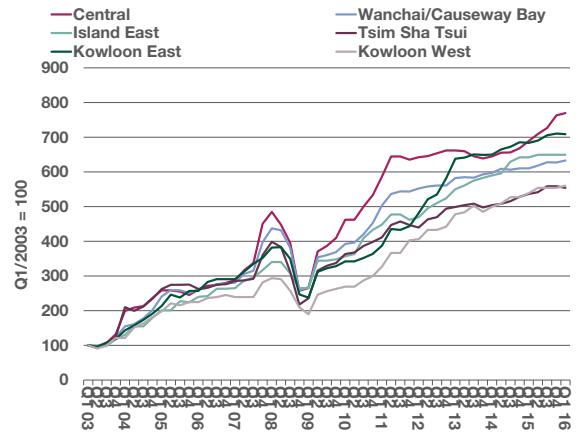


Source: Rating and Valuation Department, Savills Research & Consultancy

Causeway Bay (a 1% increment in Q1), the same could not be said for Kowloon East as some primary launches did not receive the hoped for response, with prices recording a slight decline (0.2%) over the first quarter of the year. Overall office prices remained stable in Q1/2016.

Office yields saw their first meaningful reversion from 3.0% in Q4/2015 to 3.1% in Q1/2016, with 3-month HIBOR (a proxy for the cost of a commercial mortgage) increasing from 0.39% at the end of Q4/2015 to 0.56% at the end of Q1/2016. Cautious investors, who have

GRAPH 4 Grade A office price indices by district, Q1/2003 – Q1/2016



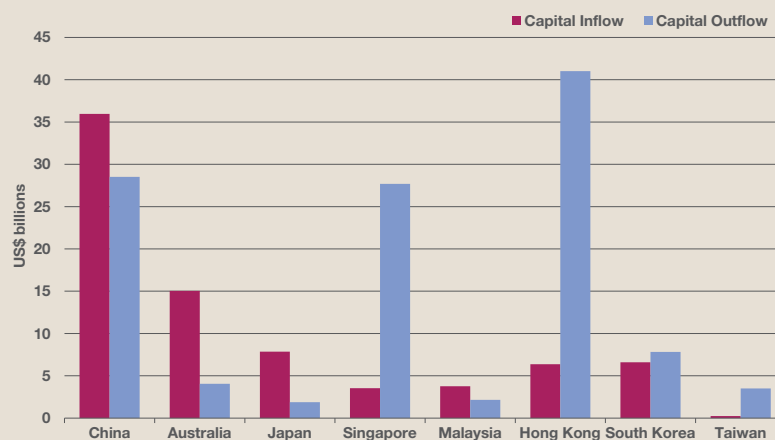
Source: Savills Research & Consultancy

enjoyed dramatic capital appreciation and generous positive carry over the past few years finally began to look more seriously at rental returns given slowing price growth and escalating funding costs. ■

Hong Kong in the region

While Hong Kong has not been the most popular destination for real estate investment within the region, having only received US\$6.36 billion of real estate capital inflows from the rest of the world in 2015, ranking it fifth among major real estate markets, it was the single largest source of real estate capital outflows in Asia in 2015. While US\$41.02 billion left the territory, beating closest rival, China, by almost US\$12.51 billion over the year, it was locally listed Chinese companies with businesses in the mainland who accounted for much of these outflows, as was the case in Singapore. Further reasons for the outflows may include a lack of opportunities at home where limited land sales, combined with falling values and heavy government regulation have made overseas markets that much more attractive.

GRAPH 5 Real estate capital inflows / outflows by country, 2015



Source: RCA, Savills Research & Consultancy

NB: All analysis based on properties & portfolios of \$2.5m and greater. Not all property deals are included in aggregate statistics (such as entity-level transactions). Estimated prices are not posted, but are used in aggregate volume.

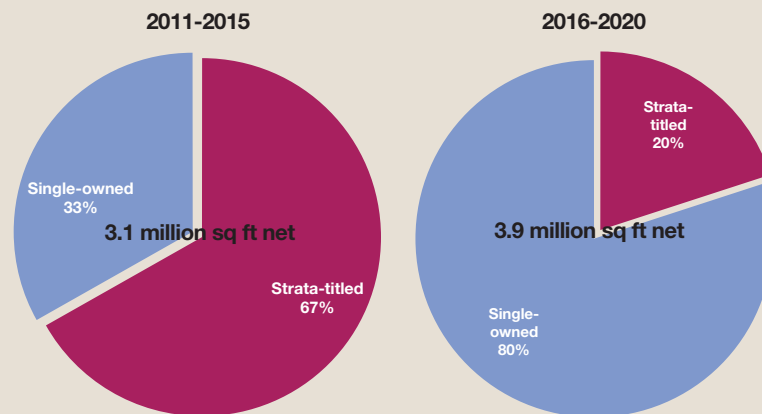
OUTLOOK

The prospects for the market

The suburban retail market looks set to continue to attract interest from yield-hungry investors looking for a stable income return, with a pipeline of projects expected over the next few months, including residential retail podiums in Tseung Kwan O and Fanling, as well as large restaurant and general retail space in fringe Kowloon, all with initial yields of 3.5% or higher. The prime street market may see more restructuring of trade and tenant mix before more landlords accept offers below their original asking prices. With more suburban transactions likely to be concluded and more prime street landlords willing to negotiate, we anticipate that transaction volumes will gradually pick up from Q2 onwards.

The stratified office sector may remain quiet over the next few months given weak investment sentiment, but we anticipate office prices may be reasonably well insulated with less new supply earmarked for stratification over

GRAPH 6
Grade A office supply by (intended) ownership, 2011-2015 vs 2016-2020



Source: Rating and Valuation Department, Buildings Department, Savills Research & Consultancy

the next five years. Of the 3.1 million sq ft net of new supply completed from 2011 to 2015, 2.1 million sq ft net or 67% was stratified, with much of the stock located in Kowloon East. Over the next five years, however, of the 3.9 million sq ft net of Grade A offices to

be completed, only 780,000 sq ft net (20%) is earmarked for strata-title sale. The dramatic decline of new strata-titled offices over the next five years should help support prices over the period, given no significant change in business or investment sentiment.

Please contact us for further information

Savills Investment

Savills Research



Raymond Lee
CEO
Greater China
+852 2842 4518
rlee@savills.com.hk



Peter Yuen
Managing Director
Head of Investment & Sales
+852 2842 4436
pyuen@savills.com.hk



Simon Smith
Senior Director
Asia Pacific
+852 2842 4573
ssmith@savills.com.hk



Jack Tong
Director
+852 2842 4213
jtong@savills.com.hk

Savills plc

Savills is a leading global real estate service provider listed on the London Stock Exchange. The company established in 1855, has a rich heritage with unrivalled growth. It is a company that leads rather than follows, and now has over 700 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East.

This report is for general informative purposes only. It may not be published, reproduced or quoted in part or in whole, nor may it be used as a basis for any contract, prospectus, agreement or other document without prior consent. Whilst every effort has been made to ensure its accuracy, Savills accepts no liability whatsoever for any direct or consequential loss arising from its use. The content is strictly copyright and reproduction of the whole or part of it in any form is prohibited without written permission from Savills Research.